No. 14623

United States
COURT OF APPEALS
for the Ninth Circuit

FORREST L. MOE and EDITH B. MOE,
Appellants,

vs.

HUGH H. EARLE, Former Collector of Internal Revenue at Portland, Oregon,
Appellee.

BRIEF OF APPELLANTS

Appeal from the United States District Court for the District of Oregon.

FILED
APR 27 1955
PAUL P. O'BRIEN, CLERK

TOOZE, KERR, HILL, DOUGHERTY & TOOZE,
LAMAR TOOZE,
ROBERT M. KERR,
STUART W. HILL,
811 Equitable Building,
Portland 4, Oregon,
Attorneys for Appellants.

STEVENS-NESS LAW PUB. CO., PORTLAND, ORE. 4-55

SUBJECT INDEX

Page

Jurisdiction 1

Statement of Case 2

Specification of Errors 10

Argument 10

Summary 10

I. The full net proceeds received by the cooperative from its sale of taxpayers' fruit were income of the taxpayers for tax purposes 11

1. The cooperative received the net proceeds not as owner but as the agent or trustee for taxpayers, or as a mere conduit for the money 11

2. Income in the amounts contributed by the taxpayers to the Building and Equipment Fund was constructively received by the taxpayers in the years such contributions were made 15

3. The taxpayers realized the economic benefit of the net proceeds of their fruit which were credited to the Building and Equipment Fund by the cooperative in satisfaction of the taxpayers' obligation to contribute to that fund 16

II. The certificates of contribution were not income to the taxpayers in the years in which issued 17

III. The cash refunds of capital contributions received by the taxpayers in 1949 and 1951 were not income to the taxpayers in those years 19

SUBJECT INDEX (Cont.)

Page

1. The equivalent of the sums of money contributed by the taxpayers to the capital fund was income to them in the years such contributions were made, and could not be income again in a subsequent year 19
2. The sums of money contributed by the taxpayers to the Building and Equipment Fund were investments in capital, and the refunding thereof constituted a return of capital not taxable as income 19

Conclusion 20

Appendix 21

TABLE OF CASES

Page

Acer Realty Co. v. Commissioner, 132 F. 2d 512 (CA 8) 16, 19

Bradshaw v. Commissioner, 14 T.C. 162 13

Burnet v. Logan, 283 U.S. 404, 51 S. Ct. 550, 75 L. Ed. 1143 20

Caswell's Estate v. Commissioner, 211 F. 2d 693 (CA 9, 1954) 18

Colony Farms Cooperative Dairy, Inc., 17 T.C. 688 13

Commissioner v. Carpenter, 219 F. 2d 635 (CA 5, 1955) 18

Commissioner of Internal Revenue v. Scatena, 85 F. 2d 729 (CA 9) 16

Davidson v. Apple Growers Ass'n., 159 Or. 474, 79 P. 2d 991 ..... 3, 14

Edwards v. Cuba Railroad Co., 268 U.S. 628, 45 S. Ct. 614, 69 L. Ed. 1124 20

Farmers Grain Dealers Assn. of Iowa v. U. S., 116 F. Supp. 685 (S.D. Iowa 1953) 15

Fruit Growers Supply Co. v. Commissioner, 56 F. 2d 90 (CA 9) 13

Grise v. Commissioner, 6 BTA 743 16

Harbor Plywood Corporation v. Commissioner, 14 T.C. 158 at 161, affirmed 187 F. 2d 734 (CA 9) 11, 13

Healy v. Commissioner, 345 U.S. 278, 73 S. Ct. 671, 97 L. Ed. 1007 19

Helvering v. Horst, 331 U.S. 122, 61 S. Ct. 144, 85 L. Ed. 75 17

Herbert v. Commissioner, 81 F. 2d 912 (CA 3) 16

Hood River Orchard Co. v. Stone, 97 Or. 158, 191 Pac. 662 12

TABLE OF CASES (Cont.)

Page

Maley v. Commissioner, 17 T.C. 260 ... 20

Midland Cooperative Wholesale v. Commissioner, 44 B.T.A. 824 ... 13

Oregon Growers Cooperative Association v. Lentz, 107 Or. 561 at 579, 212 P. 811 ... 11

Phillips v. Commissioner, 17 T.C. 1027 (1951) ... 14

Rhodes v. Little Falls Dairy Co., Inc., 230 App. Div. 571, 245 N.Y. Sup. 432, affirmed, 256 N.Y. 559, 117 N.E. 140 (1931) ... 12

Robinson v. Linn, 155 Or. 591, 65 P. 2d 669 ... 16

San Joaquin Valley Poultry Producers' Assn. v. Commissioner, 136 F. 2d 382 (CA 9) ... 13

United Cooperatives, Inc. v. Commissioner, 4 T.C. 93 ... 13

Welp v. United States, 201 F. 2d 128 (CA 8) ... 19

STATUTES

28 U.S.C.A. 1291 ... 1
28 U.S.C.A. 1340 ... 1

OTHER CITATIONS

Nieman, Multiple Contractual Aspects of Cooperatives' By-Laws, 39 Minn. L. R. 135 (Jan. 1955) ... 15

No. 14623

United States
COURT OF APPEALS
for the Ninth Circuit

FORREST L. MOE and EDITH B. MOE,
Appellants,

vs.

HUGH H. EARLE, Former Collector of Internal Revenue at Portland, Oregon,
Appellee.

BRIEF OF APPELLANTS

Appeal from the United States District Court for the District of Oregon.

JURISDICTION

This appeal, involving an action for refund of income taxes for the years 1949 and 1951 paid by the plaintiffs-appellants to the defendant-appellee as the then Collector of Internal Revenue, is taken from the final judgment of the District Court of the District of Oregon filed on October 12, 1954 (R. 72). The District Court had jurisdiction under 28 USCA 1340. Notice of appeal was filed by the plaintiffs on November 10, 1954 (R. 73). Accordingly, this Court has jurisdiction under 28 USCA 1291.

STATEMENT OF CASE

This case involves amounts contributed by the appellants (hereinafter referred to as "the taxpayers") to a capital fund of Apple Growers Association, a corporation operating as a nonprofit cooperative marketing association (hereinafter referred to as "the cooperative"), during the years 1930, 1931 and 1935 through 1937, as to which the cooperative in 1942 issued to the taxpayers "certificates of contribution to revolving capital fund". The cooperative in 1949 and 1951 refunded these amounts to the taxpayers in cash, which the taxpayers reported in their joint cash-basis income tax returns for 1949 and 1951. The taxpayers seek refund of taxes amounting to $173.44 paid on these 1949 and 1951 cash receipts from the cooperative, plus interest, on the ground that such receipts did not constitute taxable income to the taxpayers in those years.

The issue is whether the monies contributed by the taxpayer to the cooperative's capital fund through charges by the cooperative against net proceeds of sales of the taxpayers' fruit, were taxable as income to the taxpayers (a) during the years 1930-1937 when contributed to the cooperative through such charges, or (b) in 1942 when the "certificates of contribution", evidencing such charges and the corresponding capital credits, were issued by the cooperative to the taxpayers, or (c) in 1949 and 1951 when the capital contributions were refunded to the taxpayers in cash.

The Apple Growers Association was organized in 1913 under the general corporation laws of Oregon, prior to enactment of the first Oregon cooperative association statute. It operated, however, at all times here concerned as a nonprofit agricultural cooperative association, with federal income tax-exempt status under Sec. 101 (12) of the Internal Revenue Code, and on what amounted to a non-stock membership basis (Ex. 15, pages 4-9, 21, 29-31; R. 28-29, 56).[1]

The taxpayers, husband and wife, are fruit growers in the Hood River Valley of Oregon, and have been members and patrons of the Apple Growers Association and parties to its Standard Cooperative Growers Contract (Ex. 2), continuously since 1929 (R. 28, 55-56, 96). That contract (set forth in full in Appendix, *infra* p. 21) provides that the cooperative shall pool the fruit delivered to it by the taxpayers each year with fruit delivered by other growers under similar contracts, and shall pay the taxpayers their pro rata share of the net proceeds of the sale of such pooled fruit within thirty days after the cooperative's receipt of the money for that pool.

A by-law of the cooperative in effect when the taxpayers became members of the cooperative and thereafter until June 1, 1940, provided for a permanent "Building and Equipment Fund" charge based upon the amount of fruit handled by the cooperative, at a rate not

---

[1] The cooperative character of this corporation is analyzed in *Davidson v. Apple Growers Ass'n.,* 159 Or. 474, 79 P. (2d) 991 (1938).

exceeding five cents per package to be fixed by the Board of Directors, and to be used exclusively for "the purchase of or paying for property, equipment or betterments" (Appen. p. 21; R. 29-30, 56-57, 113). This fund was built up by the cooperative through an annual charge on the ledger account of each patron of the cooperative, based upon the amount of fruit handled for that patron, and at a rate per package fixed each year by the Board of Directors. Such Building and Equipment Fund charge was deducted from each patron's share of the net proceeds of the fruit pools, and was balanced by a corresponding credit to that patron's capital ledger account with the cooperative (Ex. 3, 4, 5, 6, 33; R. 30-32, 57-59, 128-131).

After the closing of each pool in which the taxpayers had fruit the cooperative supplied to the taxpayers, in accordance with its normal procedure as to all patrons, a written Pool Closing Statement (Ex. 31) showing the quantity of the taxpayers' fruit handled, prices and amount received therefor by the cooperative, the rates and amounts of the cooperative's expenses applicable to that fruit, the rate and amount of the per-box Building and Equipment Fund deduction, and the "net credit" to the taxpayers resulting from deduction of such expenses and Building and Equipment Fund charge from the gross sales proceeds. The amount of such net credit was then paid or available to the taxpayers in cash (R. 30-31, 98-99, 125-131).

The sums thus charged and credited to the taxpayers for the Building and Equipment Fund are as follows:

Year	Amount
1930	$140.46
1931	$261.48
1935	$ 78.76
1936	$116.99
1937	$100.25

Until the year 1940 there was no provision in the cooperative's by-laws for, and the cooperative did not issue, any kind of certificate evidencing such Building and Equipment Fund contributions. In that year, by an amendment to the by-laws, the Building and Equipment Fund was made a part of a revolving capital fund and provision was made for the issuance of a "certificate" each year to each member of the cooperative showing the amount of that member's contribution during the year to the revolving capital fund (Ex. 14, pp. 11-15; R. 32-37, 60-65). Accordingly, in 1942 the cooperative issued and delivered to the taxpayers five documents each entitled "Certificate of Contribution to Revolving Capital Fund", stating the amount contributed by the taxpayers to the Building and Equipment Fund during each of the five years 1930, 1931, 1935, 1936 and 1937 concerned in this action (Ex. 8, 9, 10, 11 and 12; R. 37, 65). The by-law providing for the issuance of such certificates specified that:

> "Said certificates shall not be evidence of any debt, shall not bear interest, shall give no voting rights, shall become null and void if the membership under which the 'contributions' were made shall be canceled, terminated or forfeited, and shall not be negotiable or assignable except to the purchaser of the membership under which the 'contributions' were made, together with a sale and conveyance of the premises to which the membership

pertains and then only by consent of the Board of Directors and subject to any unpaid debt or obligation of the assignor." (Ex. 14; R. 36, 64).

The form of certificates issued to the taxpayers included on its face the following:

"This is to Certify that during the fiscal year beginning June 1, _____, contributions totaling _____ were made to said fund by the above-named member or his predecessor. Upon surrender of this certificate the contributor or rightful assignee will be entitled to a refund of his pro rata share thereof with all other contributors for said year, subject to all provisions of members by-laws of the Association, when and if the Board of Directors shall determine to refund same.

"This certificate does not represent any debt owing by the Association, shall not bear interest, gives no voting rights, becomes null and void after the membership under which said contributions were made shall be by any owner thereof cancelled, terminated or forfeited, shall not be negotiable or assignable except to the purchaser of the membership under which contributions were made and the premises to which same pertains, and then only by consent of the Board of Directors of said Association and also, subject to any unpaid debt or obligation of the assignor to the Association to be assumed by such accepted assignee.

"The time and amount of any refund upon this certificate is and shall be within the discretion of the Board of Directors of Apple Growers Association and the rights hereunder are and will be governed by the members' by-laws of said Association and the holder hereof will and does accept same subject to those conditions and with that knowledge." (Ex. 8, 9, 10, 11, 12).

After issuance of the first certificates of contribution in 1942, the cooperative each year has issued such certificates during the same calendar year in which the contributions evidenced by the certificates have been made (R. 116).

The taxpayers did not file income tax returns for any of the five years prior to 1942 during which the Building and Equipment Fund contributions and credits here involved were made and entered (R. 41). They did file a timely joint return for the year 1942, on a cash-receipts basis, but did not include therein any sum represented by the certificates issued to them in that year (R. 39, 99-101).

In 1949 the cooperative, in "revolving" the Building and Equipment Fund portion of its revolving capital fund as provided by the by-law adopted in 1940, refunded to the taxpayers in cash the $401.94 which had been contributed by them to the Building and Equipment Fund during the years 1930 and 1931, upon surrender of the certificates covering these contributions (R. 38, 66). The taxpayers also received from the cooperative during the year 1949 a certificate of contribution to revolving capital fund evidencing $986.18 which the taxpayers had contributed to the revolving capital fund through deductions from net sales proceeds during the 1948-1949 fiscal year (R. 39, 67).

In their joint income tax return for the calendar year 1949 (Ex. 26), the taxpayers included the $401.94 cash Building and Equipment Fund refund received by them during that year, but they did not include the

certificate of contribution issued to them in the year 1949 or any part of that year's capital contribution evidenced by that certificate (R. 38-39, 66-67, 106-107). The taxpayer Forrest Moe had been informed in the early 1940s by the then president of the cooperative that the Bureau of Internal Revenue had advised that the members of the cooperative should report only cash received in refund of the amounts represented by such certificates, and not the certificates themselves (R. 100-101).

The Bureau of Internal Revenue caused a field audit to be made of the taxpayers' 1949 return, and the amount of the 1949 revolving fund certificate was added in the full face amount thereof, $986.18, and the consequent additional tax was assessed to and paid by the taxpayers (R. 39, 67). This was subsequent to a ruling by the office of the Commissioner of Internal Revenue dated April 13, 1950, that amounts includible for tax purposes in the gross income of cooperative association patrons were not restricted to cash distributions but also included the face amounts of revolving fund certificates (Ex. 27, 38).

In the year 1951 the taxpayers received from the cooperative cash refunds, totaling $296.00, of their contributions to the Building and Equipment Fund during the years 1934, 1935 and 1936, and they surrendered the certificates covering the same (R. 40, 68-69). They also received in 1951 a certificate evidencing their payments to the revolving capital fund during 1951 (Ex. 28). Their joint 1951 tax return included the cash refund of the 1935, 1936 and 1937 Building and Equip-

ment Fund contributions, and also the face amount of the certificate issued in 1951 (Ex. 28; R. 107).

Timely claims for refund thereafter were filed by the taxpayers covering the taxes paid by them for the years 1949 and 1951 on the cash refunds during those years of their previous contributions to the Building and Equipment Fund, on the ground that such refunds were not income to the taxpayers in those years (Ex. 29, 30).

The taxpayers contended in the District Court that under the facts peculiar to this case, their contributions to the Building and Equipment Fund of the cooperative constituted income received by them only in the years in which originally contributed, that is, in the years in which the cooperative's charges against them for its Building and Equipment Fund were deducted from the net proceeds of the cooperative's sales of their fruit and credited to their capital account; that the later issue, in 1942, of "certificates of contribution" was of no significance for tax purposes; and that the refunds to them in 1949 and 1951 of their contributions to the Building and Equipment Fund during the period 1930-1936 constituted a return to them of capital, and not taxable income.

The case was tried to the Court (Honorable Gus J. Solomon), sitting without a jury. The Court rendered an oral opinion (R. 52), but no written opinion was filed. The Court's findings of fact and conclusions of law appear on pages 54-71 of the Record.

The District Court agreed with the taxpayers that the 1942 issuance to them of the certificates of contri-

bution did not constitute or represent taxable income to the taxpayers in 1942. The Court further concluded, however, that taxable income was received by the taxpayers in the years 1949 and 1951 when they received the cash refunds, and that no taxable income was received in the earlier years when the money originally was deducted from the taxpayers' sales proceeds, for the capital fund (R. 53, 70-71).

SPECIFICATION OF ERRORS

The District Court erred:

1. In concluding that the amounts paid to the taxpayers in cash by the cooperative in 1949 and 1951 to redeem the certificates of contribution to revolving capital fund issued in 1942 to evidence Building and Equipment Fund contributions in prior years, were income to the taxpayers in 1949 and 1951, and were not income in the years in which such amounts were deducted by the cooperative from the net proceeds of the sale of the taxpayers' fruit (R. 70-71). (This specification includes Points I, II and III, R. 76-77.)

2. In entering judgment against the taxpayers dismissing their complaint (R. 70-73).

ARGUMENT

Summary of Argument

The taxpayers received full payment of the net sales proceeds of their fruit each year when a part of such proceeds was paid to them in cash and the balance was

set off by the cooperative against their obligation to contribute to the cooperative's capital fund. Accordingly any tax on that part of the net proceeds which the taxpayers invested in that manner in the capital of the cooperative accrued in the years, and only in the years, in which those capital investments were made. The "certificates" issued in 1942 were mere receipts evidencing such prior capital investments by the taxpayers, and could not constitute or represent 1942 taxable income in any amount. The cash received by the taxpayers in 1949 and 1951 in refund of the prior investments in the cooperative's capital was a return of capital and hence not taxable as income during those years.

I.

THE FULL NET PROCEEDS RECEIVED BY THE COOPERATIVE FROM ITS SALE OF TAXPAYERS' FRUIT WERE INCOME OF THE TAXPAYERS FOR TAX PURPOSES

1. The cooperative received the net proceeds not as owner but as the agent or trustee for taxpayers, or as a mere conduit for the money.

The taxpayers did not sell their fruit to the coperative, but delivered it to the cooperative for handling and marketing to others on a cooperative basis, that is, as the taxpayers' agent. *Oregon Growers Cooperative Association v. Lentz,* 107 Or. 561 at 579, 212 P. 811.

In the language of the Tax Court in *Harbor Plywood Corporation v. Commissioner,* 14 T.C. 158 at 161, affirmed, 187 F. 2d 734 (CA 9):

> " . . . the selling association is an agent or trustee or mere conduit for the income."

The Standard Cooperative Growers Contract between the taxpayers and the cooperative expressly requires the cooperative to pay to the taxpayers "the net proceeds obtained by it for the fruit within thirty days after the receipt of the money for each pool of fruit" (Ex. 2), the "net proceeds" being the gross sales receipts by the cooperative less only its costs and charges for handling, storing and marketing, as specifically listed in the contract. Deductions from gross proceeds authorized by this patronage contract do not include any charge or deduction for any capital fund of the cooperative.

The cooperative was thus legally obligated to pay to the taxpayers, along with all other growers who were parties to such patronage contracts, the full net proceeds of the fruit sold by the cooperative. Such payment of the net margins was mandatory, and not discretionary with the Board of Directors. The taxpayers could have compelled the cooperative to pay to them the full amount of the net proceeds, under their patronage contract. *Hood River Orchard Co. v. Stone,*[2] 97 Or. 158 at 171, 191 Pac. 662 (1920); *Rhodes v. Little Falls Dairy Co., Inc.,* 230 App. Div. 571, 245 N.Y. Sup. 432, affirmed, 256 N.Y. 559, 117 N.E. 140 (1931).

It thus follows that when the cooperative applied a part of the net fruit sales proceeds to discharge the

---

[2] Construing the identical form of Apple Growers Assn. Cooperative patronage contract involved in the instant case. The cooperative's bylaw establishing the Building and Equipment Fund (Ex. 14, p. 12) was adopted after trial of the *Hood River Orchard Co.* case.

taxpayers' obligation, under the by-laws, to contribute to the Building and Equipment Fund, it was applying money which belonged to the taxpayers and not to the cooperative. *San Joaquin Valley Poultry Producers' Assn. v. Commissioner,* 136 F. 2d 382 (CA 9); *United Cooperatives, Inc. v. Commissioner,* 4 T.C. 93; *Harbor Plywood Corporation v. Commissioner,* 14 T.C. 158, affirmed, 187 F. 2d 734 (CA 9); *Bradshaw v. Commissioner,* 14 T.C. 162; *Midland Cooperative Wholesale v. Commissioner,* 44 B.T.A. 824.

It is now clear that even a non-exempt cooperative which is obligated under its patronage contract with its patrons to pay the net receipts or net margins to its patrons, may exclude such net receipts from its gross income in computing its own income tax. *Fruit Growers Supply Co. v. Commissioner,* 56 F. 2d 90 (CA 9). It is also well settled that a cooperative may exclude from its gross income the net proceeds which it is obligated to pay to its patrons even though such payment may be made, in the discretion of the cooperative, partly or wholly in capital stock or revolving capital credits. *Colony Farms Cooperative Dairy, Inc.,* 17 T.C. 688; *United Cooperatives, Inc. v. Commissioner, supra.* The basis for this result is expressed by the tax court, in *United Cooperatives, Inc. v. Commissioner, supra,* as follows:

> "The result of the procedure set up in petitioner's (the cooperative's) by-laws was as if the stockholder member who was under obligation to purchase additional stock had received, in cash, the 'patronage dividend' and had thereupon applied this sum to payment of stock. The stock, when

> thus paid and issued to him . . . represented an additional investment on his part to the capital of the corporation out of his savings from the annual transactions with petitioner."

Such is precisely the situation in the instant case. The cooperative here sold fruit grown and delivered to it by the taxpayers, and was obligated under its patronage contract to pay to the taxpayers the sales proceeds less only the cooperative's operating expenses. The taxpayers, however, had agreed as members of the cooperative to the by-law requirement that certain sums, based upon the amount of their fruit handled by the cooperative, be paid each year to a capital fund (Ex. 14; R. 29-30).[3] Rather than insist upon full cash payment to them of the full net sales proceeds to which they were entitled, only to pay back to the cooperative the charges for the capital fund, the taxpayers acquiesced in the cooperative's application of a portion of those proceeds in satisfaction of the charge for the capital fund. In legal effect, the taxpayers received the full net proceeds of the fruit, and thereupon invested a portion thereof in the capital of the cooperative. *Phillips v. Commissioner,* 17 T.C. 1027 (1951). The cooperative set off the taxpayers' obligation under the by-laws to contribute to the capital fund against its own obligation under the patronage contract to pay to the taxpayers the full net proceeds of their fruit. Each of these independent obligations of the two parties was thus fully settled and discharged as to each year's crops.

---

[3] *Davidson v. Apple Growers Ass'n.,* 159 Or. 473 at 482, 79 P. (2d) 991 (1938): "* * * all grower members are bound by the provisions of the members bylaws of defendant by reason of their relationship to defendant as grower members."

There arose therefrom, however, a *new* executory contract relationship. When the cooperative credited the taxpayers with their contribution to the capital fund, a relationship in the nature of a cooperative-investor status was created, involving new rights and obligations based not upon the taxpayers' status as patrons, but upon their status as owners of equity interests in the capital of the cooperative.[4]

Farmers Grain Dealers Assn. of Iowa v. U. S., 116 F. Supp. 685 (S.D. Iowa 1953), cited in the District Court's oral opinion (R. 53), does not support a conclusion that the sums contributed by the taxpayers to the cooperative's capital fund were income when refunded to the taxpayers, and not when originally contributed. It appears that the Iowa cooperative, unlike the Apple Growers Association, was not obligated to pay to its patrons the money which it withheld for its reserve, so that its patrons could not be said to have received that money as income under any applicable theory.

2. Income in the amounts contributed by the taxpayers to the Building and Equipment Fund was constructively received by the taxpayers in the years such contributions were made.

All elements of constructive receipt of income are here present. The cooperative was legally obligated to

---

[4] "It is most important to realize that where the same individual is either (1) both a member and an investor, or (2) both a patron and an investor, or (3) a member and a patron and an investor, his rights and obligations in each capacity arise out of a different relationship than his rights and obligations in either of his other capacities." Nieman, *Multiple Contractual Aspects of Cooperatives' By-Laws,* 39 Minn. L. R. (January 1955) 135, 148.

pay the taxpayers within a specific time the full net proceeds of the sales of their fruit. The taxpayers could have demanded and enforced payment of the full net proceeds, without deduction of any capital fund charge. The taxpayers were not obliged to, but did, acquiesce in the cooperative's practice of setting off against its obligation to the taxpayers to pay to them the net proceeds of their fruit, their obligation to the cooperative to contribute to the Building and Equipment Fund. There was thus a constructive receipt of income to the taxpayers in the amount which they were entitled to receive in cash but which they permitted voluntarily to be applied upon their obligation to the capital fund. *Commissioner of Internal Revenue v. Scatena,* 85 Fed. 2d 729 (CA 9); *Acer Realty Co. v. Commissioner,* 132 Fed. 2d 512 (CA 8); *Herbert v. Commissioner,* 81 Fed. 2d 912 (CA 3); *Grise v. Commissioner,* 6 B.T.A. 743. These cases are clearly supported by the common law rule that when two debts are set off against each other by agreement, each is deemed to be paid to the extent of the setoff. *Robinson v. Linn,* 155 Or. 591, 65 P. 2d 669.

3. The taxpayers realized the economic benefit of the net proceeds of their fruit which were credited to the Building and Equipment Fund by the cooperative in satisfaction of the taxpayers' obligation to contribute to that fund.

In return for the application of their money to the Building and Equipment Fund, the taxpayers received not only the benefit of the discharge of their obligation to contribute to that fund, but also received Building

and Equipment Fund credits to their account on the books of the cooperative which entitled them to their pro rata share of the proceeds of the cooperative's assets in the event of dissolution or sale of the cooperative (Ex. 13, p. 13; Ex. 3, 4, 5, 6; R. 32).

The taxpayers thus clearly received the economic benefit of the portions of the net proceeds of their fruit which they did not physically receive but which were applied by the cooperative to its Building and Equipment Fund, and such proceeds were taxable income to the taxpayers irrespective of whether or not the actual financial benefit derived by the taxpayers therefrom was the equivalent of the money so contributed by them to that fund. *Helvering v. Horst,* 331 U.S. 112, 61 S. Ct. 144, 85 L. Ed. 75.

II.

THE CERTIFICATES OF CONTRIBUTION WERE NOT INCOME TO THE TAXPAYERS IN THE YEARS IN WHICH ISSUED

The defendant argued in the District Court that the certificates issued to the taxpayers in 1942 represented delayed receipts from the cooperative's marketing of the earlier crops and constituted ordinary income in the year 1942. The District Court held that such certificates did not constitute income in the year in which issued (R. 53, 71).

The certificates actually were mere receipts acknowledging prior contributions by the taxpayers to the Building and Equipment Fund. The patronage transactions between the cooperative and the taxpayers with

respect to their crops in the 1930s had been completed and fully settled long before issuance of the 1942 certificates. The certificates neither created nor satisfied any debt running from the cooperative to the taxpayers. The net proceeds of each crop had been paid in full to the taxpayers. No patronage refunds or net margins remained to be distributed, either in cash or in property. The "patronage contract" had been fully performed. The subsequent issuance of these certificates in no way modified, added to or otherwise affected those previously completed settlements.

Furthermore, no attempt has been made to assess a tax on the 1942 certificates. The period of limitations has run, inasmuch as the taxpayers did file a 1942 return (R. 39, 97).

Even if it could be said that the certificates did constitute a delayed non-cash distribution of net proceeds from the earlier sales of the taxpayers' fruit, they would not constitute income to the taxpayers in the years of issue, for they clearly had no fair market value at the time of issue or at any time thereafter (R. 105), and were non-negotiable, non-interest bearing, and could be assigned only with the membership in the cooperative to new members approved by the Board of Directors (R. 36-37, 144). *Caswell's Estate v. Commissioner,* 211 F. 2d 693 (CA 9, 1954); *Commissioner v. Carpenter,* 219 F. 2d 635 (CA 5, 1955).

III.

THE CASH REFUNDS OF CAPITAL CONTRIBUTIONS RECEIVED BY THE TAXPAYERS IN 1949 AND 1951 WERE NOT INCOME TO THE TAXPAYERS IN THOSE YEARS

1. The equivalent of the sums of money contributed by the taxpayers to the capital fund was income to them in the years such contributions were made, and could not be income again in a subsequent year.

Inasmuch as the sums contributed by the taxpayers to the cooperative's capital fund were contributed from the taxpayers' taxable income of the years of such contributions, it follows that the cash refunds of those capital contributions paid to the taxpayers in 1949 and 1951 were not taxable to them as income in those years, for income is taxable as such only in the year in which earned as income. *Healy v. Commissioner,* 345 U.S. 278, 73 S. Ct. 671, 97 L. Ed. 1007; *Welp v. United States,* 201 F. 2d 128 (CA 8).

2. The sums of money contributed by the taxpayers to the Building and Equipment Fund were investments in capital, and the refunding thereof constituted a return of capital not taxable as income.

The by-law of the cooperative establishing the Building and Equipment Fund required that fund to be used for capital purposes, and the fund has been so used (R. 29-30, 92). It is significant that each of the certificates issued pursuant to the later amended by-law is entitled "certificate of contribution to revolving capital fund".

Money paid to acquire something of permanent use or value in one's business is a capital investment. *Acer Realty Co. v. Commissioner,* 132 F. 2d 512 (CA 8).

This has been applied to contributions by members of cooperative associations to the cooperative's capital funds or capital reserves—such are considered as capital investments. *Maley v. Commissioner* 17 T.C. 260; *United Cooperatives, Inc. v. Commissioner of Internal Revenue,* 4 T.C. 93.

Finally, it is well settled that returns of capital are not taxable as income. *Burnet v. Logan,* 283 U.S. 404, 51 S. Ct. 550, 75 L. Ed. 1143; *Edwards v. Cuba Railroad Co.,* 268 U.S. 628, 45 S. Ct. 614, 69 L. Ed. 1124.

CONCLUSION

It is submitted that the sums paid to the taxpayers in 1949 and 1951 in refund of prior contributions to the cooperative's capital fund were not taxable income to the taxpayers in 1949 or 1951, but only in the years 1930, 1931 and 1935 through 1937 in which those sums had been realized from sales of taxpayers' fruit and contributed to the cooperative's capital fund, and that the taxpayers should be allowed to recover the taxes paid on the 1949 and 1951 capital refunds, as prayed in their complaint.

Respectfully submitted,

Lamar Tooze
Robert M. Kerr
Stuart W. Hill

Attorneys for Appellants

Portland, Oregon
April 1955

APPENDIX

STANDARD CO-OPERATIVE GROWERS CONTRACT
of the
APPLE GROWERS ASSOCIATION
of Hood River, Oregon

Adopted on the 4th day of April, 1914, by a mass meeting of the growers and readopted on the 16th day of April, 1914, by the Board of Directors of the Apple Growers Association.

THIS CONTRACT, made and entered into, in duplicate, this 9th. day of December, 1929, by and between the Apple Growers Association, a Co-operative Corporation of Hood River, Oregon, hereinafter called the Association, party of the first part and Forrest L. Moe of Hood River, Oregon, hereinafter called the Grower, party of the second part, in the manner following:

The said parties hereto, for and in consideration of the sum of One Dollar, to each in hand paid, the receipt whereof is hereby acknowledged and confessed, have and do agree as follows, to-wit:

The said Grower hereby transfers and agrees to deliver to the Association his entire crop of merchantable apples, pears, strawberries and other fruits for the year 1929, and every year thereafter, continuously, provided that the Grower may cancel this contract on March 31st of any year by giving written notice to the Association on or before March 20th of such year that he desires the same cancelled, and delivering his copy of the contract to the Association and paying any indebtedness

due to the Association from the Grower. The failure of the Grower to so notify the Association and comply with the provisions aforesaid shall operate to continue this contract in force until such notification shall be given at the proper time, and the other stipulations aforesaid shall likewise be complied with.

The APPLE GROWERS ASSOCIATION is hereby expressly authorized to pledge, hypothecate or otherwise offer for collateral the fruit mentioned in this contract for the purpose of meeting the current expenses of the Association, including necesary harvesting expenses advanced the Grower.

The Grower agrees to haul and pack his fruit in accordance with the methods and rules prescribed by the Association and to deliver the same free of expense to the Association at Hood River—(or if delivered to any other shipping point, freight and switching charges to Hood River to be born by the Grower)—at such time as may be designated by the Association. The Grower further agrees to comply with and conform to all of the rules, regulations and requirements of the Association.

The Association agrees to handle and market the Grower's fruit with due diligence; and to pay the Grower such advances from time to time as sales warrant and to pay the balance of the net proceeds obtained by it for the fruit within thirty days after the receipt of the money for each pool of fruit; it being agreed by the parties that all fruit delivered hereunder shall be pooled by the Association with other fruit delivered under

similar contracts, according to size, tier, grade, variety and time of delivery, and that the proceeds of each pool shall be distributed by the Association pro rata among the growers having fruit in such pool. In case the Association shall pack the fruit, it shall be entitled to retain from the proceeds, as a packing charge, such sum as the Association shall from year to year determine. The Association shall be entitled to retain from the proceeds a further sum, not exceeding 10¢ per box, for the storage of such fruit as may be held and stored by it in Hood River County, Oregon, in cold storage, with the understanding that such storage charge is to be charged pro rata as against the entire variety so stored. The Association shall be entitled to retain from the proceeds of the fruit and products handled by it such further sum, as an advertising, handling, distributing and marketing charge, as the Association shall from year to year determine.

It is further agreed that for the year 1929 the Association shall retain as a handling charge not to exceed 10¢ per package for strawberries, pears and apples and 5¢ for peaches or cherries in 10 lb. packages. It is further agreed that each member of the Association shall receive the same price per box for the same variety, size and grade of fruit in each pool, and that no grower shall be charged more for the services rendered to him than other growers holding similar contracts are charged by the Association for similar services.

It is further agreed that the Association shall be entitled to withdraw from any pool fruit subject to any

defect impairing the value thereof, traceable to a diseased condition, which defect was not visible at the time of the receipt of the fruit, or was not noticed at such time, but developed later. Such fruit so withdrawn shall be handled by the Association on a separate account.

It is further agreed that this contract shall become operative and binding upon the parties hereto whenever two-thirds of the shippers with the Association, holding contracts with the Association in the form adopted in 1913, have executed the foregoing contract and not otherwise, in which event the said growers contract, adopted in 1913 between the parties hereto shall immediately terminate.

IN WITNESS WHEREOF, the Association has caused this contract to be executed by its duly authorized agent and the Grower has affixed his signature hereto this 9th day of December, 1929.

APPLE GROWERS ASSOCIATION

By /s/ Victor Follenius
For the Association
/s/ Forrest L. Moe
Grower
/s/ Edith B. Moe

MEMBERS BYLAWS OF APPLE GROWERS ASSOCIATION

(Exhibit 13)

ARTICLE X

* * * *

Section 7. *Building and Equipment Fund.* There is hereby created a permanent fund of an amount equal

to from nothing to five cents per package per annum on all fruit handled by the Apple Growers Association, commencing with the fiscal year beginning June 1st, 1919, of the standard grades of fruit on which the Association's handling and marketing charges, at the time this amendment was adopted, were ten cents per package, and a pro rata amount on all packages of fruit on which the Association's handling and marketing charges were more or less than ten cents per package, at the time this amendment was adopted.

Said fund so created, shall be known as the "Building and Equipment Fund," and shall be kept separate and apart from all other funds and moneys of the Association and shall be used exclusively for the purchasing of or paying for property, equipment or betterments, for the benefit of the Members of the Association in handling and marketing their fruit, and no portion of said fund shall be paid out in any other manner or for any other purpose than as stated herein.

The amount raised in any fiscal year for such "Building and Equipment Fund," shall be in the discretion of the Board of Directors; provided, however, the amount raised for such Fund shall not exceed in any fiscal year an amount equal to five cents per standard package of the fruit handled by the Association during such fiscal year.